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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-6881

L Q MOTOR INNS, INC., SAMUEL E. BARSHOP, PHILIP M. BARSHOP, DORIS BARSHOP SPECTOR, AND NORMAN S. DAVIS

v.

BERNARD D. SPECTOR

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT.

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AND NORMAN S. DAVIS

v.

BERNARD D. SPECTOR

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Petitioners pray that a Writ of Certiorari issue to review an opinion and order of the United States Court of Appeals for the Fifth Circuit reversing an order of the United States District Court for the Western District of Texas, which had granted Petitioners' Motion to Dismiss for Lack of Subject Matter Jurisdiction on the grounds that the transaction involved was part of an indivisible Texas divorce and property settlement, solely within the jurisdiction of the State Courts, and was not a "sale" within the meaning of the Securities Exchange Act of 1934, and SEC Rule 10b-5.

OPINIONS BELOW

The opinion of the Court of Appeals is officially reported at 517 F.2d 278 (5th Cir., 1975). It is set forth herein as Appendix A, *infra,* pp. 1a through 19a. The District Court's Memorandum Opinion dismissing Respondent's claim for lack of subject matter jurisdiction, dated May 7, 1974, is set forth herein as Appendix B, *infra,* pp. 20a through 22a.

JURISDICTION

The opinion and order of the Court of Appeals for the Fifth Circuit were entered on August 8, 1975. Petitioners' Motions for Rehearing and Rehearing En Banc were denied on October 3, 1975. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

Important Undecided Questions of Federal Law.

1. In light of the Supreme Court decision in *United Housing Foundation, Inc.* v. *Forman,* ..... U.S. ....., 95 S.Ct. 2051 (1975), was the Fifth Circuit mistaken in holding that because the transaction alleged *literally* fell within the definition of "sale" found within the Securities Exchange Act, the District Court could not determine that *in fact* no "sale" of securities had actually taken place?

2. Since jurisdiction over divorce and domestic relations belongs exclusively to the laws of the states, when a federal district court determines that the transaction complained of is part of an indivisible divorce and property settlement, do the federal courts have jurisdiction to hear a complaint alleging a violation of the Securities Exchange Act of 1934?

Conflict of Decisions in the Courts of Appeals.

3. When a District Court decides a Motion to Dismiss for Lack of Subject Matter Jurisdiction must it accept the allegations of the complaint as true, even though such allegations are controverted, or can it ascertain the actual facts and dismiss the case if these facts show that no federal jurisdiction exists despite the formal sufficiency of the pleadings? The Fifth Circuit has held that a District Court must accept the allegations in a Plaintiff's complaint as true, contrary to earlier decisions by the Supreme Court and the Third, Fourth, Sixth and Tenth Circuit Courts of Appeals.

STATUTES AND RULES INVOLVED

This case involves Sections 3(a)(14) and 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(14) and 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated by the Securities and Exchange Commission, 17 C.F.R. 240.10b-5. The case also involves Rule 12(b)(1), Federal Rules of Civil Procedure. All of these Statutes and Rules are reprinted herein in Appendix C, *infra,* pp. 23a through 25a.

STATEMENT OF THE CASE

1. Factual Background.

On December 8, 1969, Doris Barshop Spector filed suit for divorce against Bernard D. Spector in 166th District Court of Bexar County, Texas. For the next two years, their attorneys attempted to negotiate a property settlement. The property settlement was extremely complicated because Doris Barshop Spector, her family and her two brothers (who are also Petitioners in this cause of action), each owned interests in numerous properties, partnerships and corporations. The parties to the divorce dis-

agreed over whether Mrs. Spector's interests in these business entities were her separate property or community property. One of the corporations involved was Barshop Motel Enterprises, Inc. (B.M.E.), a corporation engaged in the business of owning and operating motor inns. Mrs. Spector owned in her name one-third of the issued and outstanding shares of B.M.E.

In October, 1971, the parties reached general agreement about the broad outline of a property settlement. On October 20, 1971, a nonbinding outline was prepared of the settlement discussions. This draft outline stated that Mr. Spector would receive as part of an overall settlement of the divorce and property rights of the Parties "$400,000.00 'worth' of cash and/or properties and/or business interests". One problem in the settlement negotiations concerned the source of the $400,000.00 to be paid to Mr. Spector. Further meetings were held in November and December, 1971. Although Mrs. Spector owned numerous valuable properties, she did not personally have that amount of cash. The parties reached agreement at a settlement conference held December 15, 1971. This agreement was summarized in a letter dated December 17th, written by Mr. Spector's attorney, to Mrs. Spector's attorney. The pertinent parts of this letter state:

> "Under the proposed settlement agreement the following assets will be received . . . by Bernard Spector:
>
> 1. $400,000.00 in properties and/or business interests, such properties and/or business interests to be received as the parties shall agree to, and which are to be purchased as set out in paragraph 7 below. . . .
>
> 7. Any purchase of properties and/or business interests awarded to Bernard Spector under the settlement agreement shall be purchased subsequent to the entry of the divorce decree and paid on the following basis . . ."

As the letter of December 17, 1971, clearly shows, Mr. Spector did not know what assets he would receive which he would in turn "sell" for $400,000.00. The parties subsequently agreed that the business interests which Mr. Spector would receive and immediately sell back to the Petitioners would be eighteen shares of stock in B.M.E., which were less than half of the forty shares of B.M.E. that Mrs. Spector owned. Although Mr. Spector eventually received shares of B.M.E., he might equally as well have received any other asset which the Petitioners would then have bought for the identical price, as previously agreed to.

It is also plain from this letter that the $400,000.00 did not represent an agreed value of the eighteen shares of B.M.E., but was rather a sum payable to Mr. Spector in partial settlement of all of his claims against all of his wife's property. The thrust of the settlement agreement was to place $400,000.00 in cash in Mr. Spector's hands. The use of B.M.E. stock was a means of funding the settlement. The parties first agreed on the dollar figure to be received by Mr. Spector and then determined mechanical means (and source of funds) to accomplish this result.

The Property Settlement, Support and Maintenance Agreement was executed and acknowledged by the parties and approved by their counsel on March 16, 1972. The 166th District Court of Bexas County, Texas, entered its divorce judgment, of which the property settlement was a part, at 1:30 p.m. that day.[1] The parties to the divorce then left the courthouse and proceeded to a nearby bank.

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[1] This was a contractual judgment which under Texas law had no decretal value, but merely carried out and approved the contract of the parties. *Edwards* v. *Gifford,* 155 S.W.2d 786 (Tex., 1941); *Wright* v. *Allstate Insurance Company,* 285 S.W.2d 376 (Tex. Civ.App.-Dallas, 1955) writ ref'd, n.r.e.; *Empire Gas & Fuel Co.* v. *Railroad Commission of Texas,* 94 S.W. 2d 1240 (Tex. Civ.App.-Austin, 1936) writ ref'd.

There they signed the fourteen other instruments, all prepared and approved prior to the divorce, which were necessary to effectuate the terms of the divorce decree and property settlement. One of these instruments was the previously contracted to "sale" of eighteen shares of B.M.E. stock from Bernard Spector to the corporation. This agreement was signed by the Parties less than an hour after the divorce and property settlement was entered by the Court. At that point, Mr. Spector was handed a B.M.E. certificate which he then endorsed back to the corporation. The eighteen shares of B.M.E. stock were never in Mr. Spector's possession for more than the few seconds necessary for him to sign the previously prepared endorsement on the stock certificate. He received cash, notes and other consideration as set out in the property settlement agreement and the agreement for the purchase of B.M.E. stock.[2]

Both parties and their counsel agreed upon a dollar amount and only after that dollar amount was decided did they agree that the funds to pay such amount would come from B.M.E. All of the documents to effectuate the overall property settlement agreement, including the stock "purchase" were drafted, approved and agreed to over a three month period prior to the divorce.

---

[2] The property settlement agreement, the divorce judgment and all of the documents executed to carry it out, including the "sale" of the B.M.E. stock, were, under the Texas law, one contract. *Guadalupe-Blanco River Authority* v. *City of San Antonio,* 200 S.W. 2d 989 (Tex., 1947); *Peterson* v. *Miller Rubber Company of N.Y.*, 24 F.2d 59 (8th Cir., 1928); *Veal* v. *Thomason,* 159 S.W.2d 472 (Tex., 1942); *V.H. Pritchard* v. *Nelson,* 147 F.2d 939 (4th Cir., 1945); *Board of Insurance Commissioners* v. *Great Southern Life Ins. Co.,* 239 S.W.2d 803 (Tex., 1951); and *Bowersock Mills & Power Co.* v. *Commissioner of Int. Rev.,* 172 F.2d 904 (10th Cir., 949). Respondent did not challenge these authorities, except by an unsupported assertion that the B.M.E. stock purchase was a separate legal transaction.

After the divorce, in the forty-five minutes which elapsed between its entry and the signing of the agreement to purchase B.M.E. stock, there were no negotiations regarding whether the previously agreed to B.M.E. stock transaction would occur or as to the amount of money involved. Mr. Spector did not have the option of refusing to transfer the stock of B.M.E.

The transfer of the stock was the automatic result of the agreement reached before the divorce judgment was entered, and was an integral part of the indivisible divorce and property settlement. Within an hour after the divorce, the pre-arranged B.M.E. stock transaction was carried out for the pre-arranged dollar amount at the pre-arranged time.

In March, 1973, B.M.E.'s assets were acquired by L Q Motor Inns, Inc., ("L Q"), subject only to stated liabilities, which did not include any liability to the Respondent. Shortly thereafter L Q became a "public company" by means of a sale of its shares in a public offering. L Q did not exist at the time of the divorce and property settlement. It was formed out of the assets of B.M.E. and more than forty other individuals, partnerships and corporations.

2. Proceedings Below.

On November 16, 1973, Bernard Spector filed a complaint in the Western District of Texas against Petitioners alleging several causes of action. Jurisdiction of the District Court was invoked under the Securities Exchange Act of 1934 (15 U.S.C. § 78aa). The first cause of action alleged a violation of Section 10(b) of the 1934 Act, and Rule 10b-5. The second through fifth causes of action alleged various state claims and sought to invoke the District Court's pendent jurisdiction.

On January 15, 1974, the Petitioners filed a Motion to Dismiss for Lack of Subject Matter Jurisdiction, to which they attached numerous exhibits and affidavits, together with their supporting brief. Subsequent to that date, the Respondent filed an amended complaint, a brief on the legal issues involved and affidavits and exhibits of his own. A hearing was held on Petitioners' Motion to Dismiss on April 24, 1974, at which time the Court heard extensive oral arguments from counsel. On May 7, 1974, the Court entered a Memorandum Opinion dismissing the Respondent's claim for lack of subject matter jurisdiction. On the basis of the exhibits and the affidavits before it, the Court disregarded the allegations in the Respondent's complaint and found that the alleged stock purchase agreement was an indivisible part of a divorce and property settlement. The Court further found that the transaction complained of was not a "sale" within the meaning of the Federal Securities Law.

The Respondent appealed the trial court's decision to the Fifth Circuit. On August 8, 1975, the Fifth Circuit reversed the opinion of the District Court and remanded the case for further proceedings. The Fifth Circuit denied Petitioners' Motions or Rehearing and Rehearing En Banc on October 3, 1975. The Fifth Circuit took the position that the well-pleaded *allegations* in the Respondent's complaint must be accepted as true. This necessarily cut off any inquiry into whether the jurisdictional *facts* in actuality supported the jurisdictional *allegations* of a federal cause of action.

REASONS FOR GRANTING THE WRIT

I.

IN LIGHT OF THE SUPREME COURT'S DECISION IN *UNITED HOUSING FOUNDATION, INC.* v. *FORMAN*, THE FIFTH CIRCUIT WAS MISTAKEN IN RULING THAT BECAUSE PART OF THE TRANSACION COMPLAINED OF IN THIS CASE FELL WITHIN THE LITERAL DEFINITION OF A "SALE", THE DISTRICT COURT COULD NOT DETERMINE THAT IN FACT NO SALE OF SECURITIES HAD ACTUALLY TAKEN PLACE.

The District Court held that no "sale" of stock within the meaning of the Federal Securities laws had taken place. The District Court reached this conclusion after studying all of the evidence, affidavits and exhibits presented to it. The uncontradicted evidence before it revealed that in partial settlement of all of his claims against all of his wife's property in numerous properties, partnerships and corporations, the Respondent agreed to receive $400,000.00 in cash, in an unspecified property, or in business interests. It later became apparent that Mrs. Spector could not raise $400,000.00 in cash and the Respondent agreed to accept property or business interests which he would then *immediately* sell after the divorce for the agreed amount. Thus, in December, 1971, the Respondent agreed to receive an unknown asset which he would then sell for a prearranged price. The District Court rightly concluded that no fraud in connection with a "sale" of stock has occurred when an individual agrees to sell an unknown asset to be chosen later for a prearranged price.

It is implicit in the concept of a "sale" under the Federal Securities Laws that at the time the price is agreed on, the "seller" know he is selling securities. Conversely stated, the

principle should be that there is no sale of a "security" where there is an agreed overall settlement calling for delivery of a then-unspecified asset to a then-unspecified buyer for a specified amount, and *later* the asset chosen to accomplish such "settlement" is corporate stock. Respondent was not an investor in securities nor was he engaged in a securities transaction. He was merely engaged in settling his divorce and he now attempts to use the Federal courts to secure more than his settlement provided from his wife, her brothers, and the lawyer who represented them.

The decisions of this court have made it clear that the principal purpose of the Federal Securities laws is to protect the interests of the investor in securities. This point was made in *Superintendent of Insurance of the State of New York* v. *Banker's Life & Casualty Co.,* 404 U.S. 6 (1971), when the Supreme Court maintained at 13:

> "The crux of the present case is that Manhattan suffered an injury as a result of deceptive practice touching its sale of securities as an investor."

See *Kahan* v. *Rosenstiel,* 424 F.2d 161, 173 (3rd Cir., 1970). It is the economic reality of the transaction that is important, and not the labels that are affixed to it. As the Supreme Court pointed out in *Tcherepnin* v. *Knight,* 389 U.S. 332 (1967) at 336:

> "[I]n searching for the meaning and scope of the word 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality."

The District Court used this standard in ascertaining the significance of the transactions of which the Respondent complained. It found that the stock purchase agreement was an integral part of an indivisible divorce settlement. It knew that the Respondent had agreed to sell an

unknown asset for a prearranged price before he knew that asset would be B.M.E. stock. Dealing with the substance of the transaction and disregarding its form, the court concluded that no "sale" had taken place within the meaning of the Federal Securities laws. It is apparent that this decision reflects the economic reality of the transaction. How could anything the Petitioners might have said or omitted to say in relation to B.M.E. constitute a fraud on Respondent that induced him to sell B.M.E. stock at a lower price than he otherwise would have, when the price was agreed upon before the Respondent even knew that it was B.M.E. stock he was talking about?

In its opinion, the Fifth Circuit did not engage in any analysis of the economic reality of the transactions. It made no attempt to separate the form of the stock purchase agreement from its substance. It did not dispute the District Court's finding that the suit arose out of a divorce property settlement. In fact, it agreed that this was the case. Instead, it employed a purely mechanical test to determine whether the transaction complained of fell within the definition of "sale" found within the Securities Exchange Act (15 U.S.C. § 3(a)(14)). The court then concluded, at 285:

> "To label this transaction a 'sale' requires no strained construction of that term."

Assuming, *arguendo,* that the transaction which is the basis of this law suit falls within a literal definition of the term "sale", that is not the end of the inquiry as the Fifth Circuit assumed. The question remains whether the transaction is the type intended to be covered by the Securities Exchange Act. The statute is not to be applied mechanically, without concern for its intent and purpose.

This was made clear by the Supreme Court just this year in its landmark decision in *United Housing Foundation, Inc.* v. *Forman,* ..... U.S. ....., 95 S.Ct. 2051 (1975). This case was decided after the instant cause of action had already been briefed and argued before the Fifth Circuit. In *Forman,* the plaintiffs were tenants in cooperative apartments. In order to buy an interest in the project which entitled them to apartments in the cooperative, they had to purchase shares of stock in the corporation building the project. The plaintiffs later sued under Rule 10b-5 and claimed that the rents charged them were higher than promised by the corporation at the time it sold them its stock. The defendants moved to dismiss for lack of subject matter jurisdiction, claiming that the shares of stock involved were not "securities" within the meaning of the Securities Exchange Act. They argued that the sole purpose of the individuals purchasing stock was to acquire an apartment rather than to make an investment. They noted that it was virtually impossible to make a profit on the stock because every tenant at the time he moved out of the apartment cooperative had to offer his stock back to the corporation at the price he had purchased it. The Supreme Court analyzed the situation in some depth, looked at the substance of the situation rather than its form, placed its emphasis on the economic realities and concluded that the stock which was the subject of the suit was not a "security" within the meaning of the Securities Exchange Act. It reached that decision despite the fact that the transaction involved dealt with shares of something called "stock", just as in the instant case the transaction involved was called a "purchase and sale". The Supreme Court explained its reasons for this decision at 2058-2059:

> "We reject at the outset any suggestion that the present transaction, evidenced by the sale of shares called

> 'stock' must be considered a securities transaction simply because the statutory definition of a security includes the words 'any . . . stock'. Rather we adhere to the basic principle that has guided all of the Court's decisions in this area: '[I]n searching for the meaning and scope of the word "security" in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality.' Tcherepnin v. Knight, 389 U.S. 332, 336, 88 S.Ct. 548, 19 L.Ed. 2d 564 (1967). . . .
>
> The primary purpose of the Securities Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulations to prevent fraud and to protect the interest of investors. Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto. Thus, in construing these Acts against the background of their purpose, we are guided by the traditional canon of statutory construction: 'that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers.' Church of the Holy Trinity v. United States, 143 U.S. 457, 459, 12 S.Ct. 511, 512, 36 L.Ed. 226 (1892). See also United States v. American Trucking Assns., Inc., 310 U.S. 534, 543, 60 S.Ct. 1059, 1063, 84 L.Ed. 1345 (1940)."

Based on this standard, Petitioners contend that the divorce property settlement which is the basis of this suit can clearly be seen to fall outside the scope of the Federal Securities laws, even though one part of the entire divorce property settlement has been labeled a "purchase and sale" of stock.

The *Forman* case dealt with the meaning of the word "security" within the context of Rule 10b-5. However, other decisions in recent years express the same philosophy that it is the economic reality of the transaction that governs rather than the name by which it is called. In *Kern County Land Co.* v. *Occidental Petroleum Corp.,* 411 U.S. 582 (1973), the Supreme Court dealt with the issue of whether, in the context of Section 16(b) of the Securities Exchange Act, the word "sale" must be given a literal interpretation. Once again, the court examined the economic realities, dealing with the substance of the transaction involved, rather than its form. The court concluded at 594-595:

> "In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent — the realization of short-swing profits based upon access to inside information — thereby endeavoring to implement congressional objectives without extending the reach of the statute beyond its intended limits. . . . Thus, '[i]n interpreting the terms 'purchase' and 'sale,' courts have properly asked whether the particular type of transaction involved is one that gives rise to speculative abuse.' Reliance Electric Co. v. Emerson Electric Co., *supra,* 404 U.S., at 424 n. 4, 92 S.Ct., at 600."

Applying this standard of analysis, the court held the transaction complained of did not fall within the scope of Section 16(b), even though a "sale" literally occurred. Thus, while interpreting another section of the same law, the Supreme Court decided that the exact term which is involved here ("sale") should not be applied literally.

The Second Circuit has already considered the question of whether the term "sale" should be given a literal interpretation in the context of Section 10(b) and Rule 10b-5.

In *International Controls Corp.* v. *Vesco,* 490 F.2d 1334 (2nd Cir., 1974), cert. denied, 417 U.S. 932 (1974), the Second Circuit held that in deciding whether a transaction fell within the subject matter jurisdiction of the Federal courts under Section 10(b) and Rule 10b-5, the term "sale" could not be literally interpreted. The court observed at 1346:

> "We therefore reject our dissenting brother's paean to literalness in construing the term 'sale' to require the passage of consideration in order to inject the requisite significance into the disposition of securities. Learned Hand wisely counseled: 'Of course it is true that the words used, even in their literal sense, are the primary, and ordinarily the most reliable, source of interpreting the meaning of any writing: be it a statute, a contract, or anything else. But it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary; but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning.' Cabell v. Markham, 148 F.2d 737, 739 (2d Cir. 1945)."

This, of course, is the very issue which must be determined in the instant cause of action.

Also applicable to this case is the decision of the Supreme Court in *Blue Chip Stamps* v. *Manor Drug Stores,* ..... U.S. ....., 95 S.Ct. 1917 (1975), which considered who could qualify as a plaintiff under a private cause of action for damages for violation of Rule 10b-5. In *Blue Chip,* the court held that it is only persons who are purchasers and sellers of *securities* who can properly be plaintiffs and stated, at 1925:

> ". . . [J]ustification is absent when there is no actual purchase or sale of securities, or a contract to do so, affected or tainted by violation of § 10(b)."

Since *Blue Chip* does require that one be an actual purchaser or seller of *securities,* it would appear that to be such a "seller", one must know at the time the price is agreed on that he is selling a *security,* rather than an unknown asset to be agreed on later. Here, Respondent made no such showing and could not do so.

In *Forman,* the Supreme Court held that the term "security" could not be given a literal and mechanical application in the context of Section 10(b) and Rule 10b-5. In *Kern County Land Co.,* the Supreme Court held the term "sale" could not be given a literal and mechanical application in the context of Section 16(b). In *International Controls Corp.,* the Second Circuit held that the term "sale" could not be given a literal and mechanical application in the context of Section 10(b) and Rule 10b–5. It is time that the Supreme Court extended the doctrine that substance rules over form and the economic realities of the situation must be looked at to cover the definition of the word "sale" within the context of Section 10(b) and Rule 10b-5.

The position adopted by the Fifth Circuit runs counter to this entire trend in Federal Securities law. The language which the Fifth Circuit used in its decision makes it clear that the court, unlike the trial court below, made no attempt to analyze the economic realities of the transaction to decide what its substance was, and this is the test which the Supreme Court approved and applied, in the *Forman* and *Kern County Land Co.* cases. Nevertheless, the Fifth Circuit based its decision upon the fact that the stock transaction fell within the literal definition of a "sale".

Prior to the Supreme Court's decision in *Forman,* there was some precedent for taking the "literal" approach. Indeed, a different panel of the Second Circuit than the one which decided the *International Controls Corp.* case used

this exact standard when it heard the *Forman* case below. In *Forman* v. *Community Services, Inc.,* 500 F.2d 1246 (2nd Cir., 1974), the Second Circuit held at 1252:

> "One basis for such a finding is the so-called literal approach. . . . According to this approach the fact that 'stock' certificates are used in a 'stock' corporation is sufficient in itself to bring transactions in the 'stock' within the literal definition of the Acts. . . . 'When a stock corporation is used the securities acts literally apply, even though the profit motive is not dominant.' Professor Loss has put it, 'When the ownership of an individual apartment is evidenced by stock in the cooperative, as it usually is, the federal and state securities statute would seem literally to apply' 1 L.Loss, Securities Regulation 492-93 (2d ed. 1961) (footnotes omitted). Judge Mansfield as a district judge supported the literal application of specific definitions of securities so as to *include* instruments within the coverage of the acts. Movie-lab, Inc. v. Berkey Photo, Inc., 321 F.Supp. 806 (S.D.N.Y. 1970) aff'd, 452 F.2d 662 (2d Cir. 1971). The Supreme Court said in SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344, 351 64 S.Ct 120, 123, 88 L.Ed. 88 (1943), reaffirmed in Tcherepnin v. Knight, 389 U.S. at 339, 88 S.Ct. 548, 'In the Securities Act the term "security" was defined to include by name or description many documents in which there is common trading for speculation or investment. Some, such as notes, bonds and stocks, are pretty much standardized and the name alone carries well-settled meaning. . . . *Instruments may be included within any of these definitions as a matter of law, if on their face they answer to the name or description.* However, the reach of the Act does not stop with the obvious and commonplace. . . .' (emphasis added [by the Second Circuit]). This language gives support to the proposition that if a given instrument is a share of stock 'on its face' it is literally within the ambit of the statute."

The Second Circuit applied this standard and was told by the Supreme Court that it had erred in so doing. It

should not have adopted a literal definition of the term "stock", but instead should have examined the economic realities of the situation before it.

Since *Forman* was decided after this case was heard, the Fifth Circuit, applying the same standard as the Second Circuit in *Forman,* was in error when it decided that the transaction complained of here was a "sale" of securities merely because literally the transaction would seem to fall within the scope of the Securities Exchange Act. Thus, the Fifth Circuit did exactly what the Supreme Court held was error in *Forman.*

II.

THE FIFTH CIRCUIT HAS SUMMARILY EXTENDED THE SECURITIES EXCHANGE ACT TO COVER TRANSACTIONS WHICH ARE AN INTEGRAL PART OF AN INDIVISIBLE DIVORCE AND PROPERTY SETTLEMENT, CONTRARY TO THE LONGSTANDING FEDERAL POLICY LEAVING THE ENTIRE FIELD OF DIVORCE AND DOMESTIC RELATIONS TO THE STATE COURTS.

The Fifth Circuit dismissed the contention that the purchase of stock agreement which is the basis of the Respondent's suit was part of an indivisible divorce and property settlement in two sentences. It held, at 282:

> "To be sure, this case presents a novel factual setting for a federal claim for securities fraud, as it arises out of a property settlement in a divorce action. Although the divorce and its attendant property settlement are conrolled by state law, plaintiff's 10b-5 claim falls

> within the subject matter jurisdiction of the federal courts."

In reaching this position, the Fifth Circuit rejected the century old doctrine that the entire field of divorce and domestic relations is within the exclusive jurisdiction of the state courts.

It is a long established principle of federal law that the federal courts do not have jurisdiction in divorce cases. This rule was stated by the Tenth Circuit in *McCarty* v. *Hollis,* 120 F.2d 540 (10th Cir., 1941) at 542:

> "A United States court is without jurisdiction to grant divorces or annul marriages. It has been consistently said without deviation that the field of domestic relations affecting husband and wife, or parent and child, belongs exclusively to the laws of the states."

In *Lutsky* v. *Lutsky,* 310 F.Supp. 517 (S.D. Fla., 1970), the plaintiff attempted to evade this doctrine by claiming that she was not seeking a divorce, but rather a "declaration" of her marital status. The court dismissed for lack of jurisdiction, holding at 519:

> "The [diversity] statute, however, has had carved from it two judicially made exceptions—divorce and probate —where the federal court will not act even though diversity is present. . . .
>
> We disclaim altogether any jurisdiction in the courts of the United States upon the subject of divorce."

In *Gargallo* v. *Gargallo,* 472 F.2d 1219 (6th Cir., 1973), the plaintiff sought to litigate child custody, rather than a divorce decree itself. Nevertheless, the court rejected his claim that it had jurisdiction to hear his case. It maintained at 1220:

> ". . . [T]his court is bound by the long standing exception to the statute that Federal Courts will not accept jurisdiction in domestic relations cases. . . . 'The whole subject of the domestic relations of husband and wife, parent and child, belongs to the laws of the states, and not to the laws of the United States.'" [citing in re Burris, 136 U.S. 586]

The court in *Shiffman* v. *Askew,* 359 F.Supp. 1225 (M.D.Fla., 1973) aff'd *sub nom Makres* v. *Askew,* 500 F.2d 577 (5th Cir., 1974), concluded at 1229, 1231:

> "From the inception of our federal system . . . the Supreme Court has consistently recognized the unique status of marriage and divorce as involving a myriad of socio-legal ramifications, virtually all of which are left to the exclusive province of the states. In 1858, the court declared: '. . . we disclaim altogether any jurisdiction in the courts of the United States upon the subject of divorce, or for the allowance of alimony . . .' Barber v. Barber, 62 U.S. (21 How.) 582, 584, 16 L.Ed. 226 (1858). . . .
>
> The significance of these authorities vis-a-vis the present case is threefold. First, it is indelibly ingrained in our federal system that the entire field of marriage and divorce is left to the individual regulation of the several states."

This century old doctrine has recently been affirmed by the Supreme Court in *Sosna* v. *Iowa,* 419 U.S. 379 (1975). In *Sosna,* Iowa's divorce residency requirement came under attack. In upholding the Iowa law, the court observed at 386:

> "The durational residency requirement under attack in this case was a part of Iowa's comprehensive statutory regulation of domestic relations, an area that has long been regarded as a virtually exclusive province of the States. Cases decided by this court over a period of more than a century bear witness to this historical fact."

The Plaintiff in *Sosna* contended that Iowa's durational requirement was unconstitutional. No such claim can be made in the instant cause of action, since the Federal Securities laws are of statutory rather than constitutional origin. Thus, once again the Supreme Court has reaffirmed the doctrine that the entire field of domestic relations is within the sole jurisdiction of the state courts, as long as the Constitution is not violated.

The Fifth Circuit recognized that the Respondent's cause of action arose out of a divorce property settlement (at page 282). However, it off-handedly dismissed the significance of this fact with the bald assertion that nevertheless the Respondent's claim fell within the subject matter jurisdiction of the federal courts. Under the doctrine cited above, however, if the transaction is truly an integral part of an indivisible divorce and property settlement, then the federal courts can have no jurisdiction over it, no matter what labels the Respondent decides to use. In *Lutsky,* the plaintiff called her complaint a suit for a "declaration" of her martial status, rather than a suit for a divorce. In the instant case, the Respondent has chosen to label his claim a suit for securities fraud, rather than a suit to reopen and improve his entire divorce property settlement. Nevertheless, if in fact it is a suit to reopen his divorce property settlement, then the label which Respondent attaches is entirely irrelevant.

The district court, after considering the affidavits and exhibits, concluded that the transaction complained of was an integral part of an indivisible property settlement. Nothing in the Fifth Circuit's opinion in any way intimates that the district court was in error in reaching this conclusion based on the evidence before it. Without considering the point or citing a single authority, dealing with a case which

it admitted (at page 282) presented a novel factual setting for a federal claim of securities fraud, the Fifth Circuit overturned a doctrine which has endured for more than a century and has been reaffirmed by the Supreme Court only this year.

The implications of this hastily arrived at holding are serious in the extreme. The holding will drastically change the laws relating to divorce settlements, particularly in Texas and other community property states. At any time afer a divorce property settlement where corporate stock is involved, a party who later becomes dissatisfied will be able to claim the benefits of some portions of the property settlement and attempt to use the Federal courts to improve that part of the settlement which involves corporate stock without reopening the entire settlement. Under Texas law, when a property settlement is reopened all portions of the settlement come before the court, not merely those with which the plaintiff is dissatisfied. *Smith* v. *Smith,* 468 S.W.2d 139 (Tex. Civ. App.-Dallas, 1971) no writ history. Under the Fifth Circuit's holding, the parties to every such divorce, their families and their counsel will be subject to new broad, undefined responsibilities and liabilities imposed upon them because they participate in the divorce process—a matter which all the parties in this case concede is governed by state law—simply because the property settlement partially involves corporate stock.

Either party to a divorce suit in which corporate stock is involved will be able to work out the best settlement which said party can obtain and then have access to the federal courts to improve his settlement, free of the burden (and of the risk) imposed upon him in the state courts, which would reopen the entire settlement and not just a portion of it. The federal courts will thus become courts of second resort for former divorce litigants to improve

part of their settement without reopening the entire property agreement, and without the accompanying risk that such complainant might be treated less favorably in that event.

It has always been a judicial policy of the federal courts to promote finality of judicial decisions. To allow plaintiffs to relitigate their property settlements in federal court would be to open a Pandora's box by vastly expanding the scope of the Federal Securities laws. No divorce property settlement will ever become final until the appropriate statute of limitations applicable to Rule 10b-5 suits has expired. The creation of such turmoil will serve no useful end and will undermine the previous exclusive jurisdiction of state courts in divorce cases. Such a result is particularly unnecessary since the Respondent in this case has a perfectly adequate remedy in the courts of the State of Texas, where, if he wishes, he can assert the alleged fraud and relitigate his divorce property settlement to his heart's content.

The decision of the Fifth Circuit presents a new and important question of federal law for the Supreme Court to decide. As the Fifth Circuit acknowledged, the Respondent's alleged cause of action presents a novel factual setting for a claim of securities fraud. As far as the Petitioners are aware, it is the first case in which the alleged securities fraud was an integral part of an indivisible divorce property settlement. It would thus be appropriate for the Supreme Court to decide whether such a transaction is covered by the Federal Securities laws. Moreover, this is a question of wide general import. Numerous divorce property settlements involving corporate stock are agreed to every year in Texas and in other states. The precedent which the Fifth Circuit has so off-handedly created would apply to each and every one of these property settlements, too.

III.

THE FIFTH CIRCUIT'S REFUSAL TO LOOK BEHIND THE ALLEGATIONS IN THE RESPONDENT'S COMPLAINT CONFLICTS WITH PREVIOUS DECISIONS OF THE SUPREME COURT AND THE THIRD, FOURTH, SIXTH AND TENTH CIRCUIT COURTS OF APPEALS AS TO THE PROPER PROCEDURE TO BE EMPLOYED WHEN A MOTION TO DISMISS FOR LACK OF SUBJECT MATTER JURISDICTION CHALLENGES THE JURISDICTIONAL FACTS ALLEGED.

The central pivot upon which the Fifth Circuit's decision turns is its holding that on an appeal from dismissal for lack of jurisdiction, the allegations of the complaint must be taken as true. The trial court did not follow this course of action. It received evidence in the form of affidavits and exhibits and it determined issues of fact. It decided that contrary to the allegations in the complaint the so-called "sale" of stock was part of an indivisible divorce and property settlement, and that the transaction in question was not a "sale" within the meaning of the Federal Securities Laws. The Fifth Circuit did not conclude that the trial court had wrongly decided these issues of fact. but held that the trial court *could not even consider them.* It held that the well-pleaded allegations in the complaint *had* to be accepted as true. Therefore, the evidence which the Petitioners introduced to prove the contrary was not considered by the Fifth Circuit.

The position taken by the Fifth Circuit flatly contradicts earlier rulings of the Supreme Court and four other Courts of Appeal. The Supreme Court made it absolutely clear that Plaintiff's allegations do not control on a motion to dismiss for lack of subject matter jurisdiction in *McNutt* v. *General Motors Acceptance Corporation,* 298 U.S. 178 (1936). The court held at 184:

> ". . . [T]he trial court is not bound by the pleadings of the parties, but may, of its own motion, if led to believe that its jurisdiction is not properly invoked 'inquire into the facts as they really exist.' "

The Supreme Court further amplified Plaintiff's responsibility in connection with alleging jurisdictional facts at 189-190:

> "He must allege in his pleading the facts essential to show jurisdiction. If he fails to make the necessary allegations he has no standing. If he does make them, an inquiry into the existence of jurisdiction is obviously for the purpose of determining whether the facts support his allegations. In the nature of things, the authorized inquiry is primarily directed to the one who claims that the power of the Court should be exerted in his behalf. As he is seeking relief subject to this supervision, it follows that he must carry throughout the litigation the burden of showing that he is properly in court. *The authority which the statute vests in the court to enforce the limitations of its jurisdiction precludes the idea that jurisdiction may be maintained by mere averment or that the party asserting jurisdiction may be relieved of its burden by any formal procedure.* If his allegations of jurisdictional facts are challenged by his adversary in any appropriate manner, he must support them by competent proof." (emphasis supplied)

Three years later, in *Gibbs* v. *Buck,* 307 U.S. 66 (1939), the Supreme Court reiterated that the trial court can go behind the allegations to determine the facts. The court maintained at 72:

> ". . . [T]he burden of showing by the admitted facts that the Federal Court has jurisdiction rest upon the complainants. If there were any doubt of the good faith of the allegations, the court might have called for their justification by evidence. . . ."

The same position has been adopted by several Courts of Appeals which have considered the issue. The Third Circuit stated the basic rule in *Shahmoon Industries, Inc.* v. *Imperato,* 338 F.2d 449 (3rd Cir., 1964) at 451:

> "'. . . On every writ of error or appeal the first and fundamental question is that of jurisdiction, first, of this court, and then of the court from which the record comes. . . .' The rule applies even though the pleadings are sufficient but the record does not support the allegations."

If the record does not support the jurisdictional allegations, the case should be dismissed for lack of jurisdiction.

The Third Circuit considered the problem again in *Local 336, American Fed. of Musicians, AFL-CIO* v. *Bonatz,* 475 F.2d 433 (3rd Cir., 1973). There, the court reversed the finding of lack of subject matter jurisdiction. It did not do so, however, because the allegations of the complaint must be taken as true. Instead, it reversed because the trial court had not given the Plaintiff an opportunity to present his version of the facts before the case was dismissed. The central issue in the case was whether the contract involved fell within the coverage of Section 301 of the Labor-Management Relations Act of 1947. The trial court held the contract did not fall within the Act and dismissed the case for lack of jurisdiction. The Third Circuit reversed, maintaining at 437-438:

> "The jurisdictional issue having been raised at this juncture we can not say that as a matter of law Exhibit A is a § 301 contract. We hold only that it was error for the district court to decide that issue with this record on a *sua sponte* Rule 12(b)(1) motion. We recognize that the district courts have more latitude as to modes of proof and the disposition of issues of jurisdictional fact. . .. But we have never departed from the

> rule that even on such an issue the record must clearly establish that after jurisdiction was challenged the plaintiff had an opportunity to present the facts by affidavit or by deposition, or in an evidentiary hearing, in support of his jurisdictional contention. . . .The existence of an agreement between a labor organization and an employer is, for § 301 purposes, a jurisdictional fact. For the determination of that fact, no doubt, those more liberal modes of proof apply which the Supreme Court has approved for jurisdictional determination. Whether the court proceeds by considering affidavits or depositions or by an evidentiary hearing, however, something must appear of record to contradict the pleaded and uncontroverted jurisdictional allegation that there was a § 301 contract and support the District Court's determination."

The case was reversed because the plaintiff had not been given a chance to present evidence to convince the district court that the conract fell within §301 of the Labor-Management Relations Act. However, the Third Circuit's decision makes it plain that if after considering all the evidence, the trial court then concluded that there was no contract within the scope of §301, the case should be dismissed for lack of subject matter jurisdiction even though the jurisdictional allegations in the plaintiff's complaint were sufficient.

The Fourth Circuit reached the same conclusion in *Prack* v. *Weissinger,* 276 F.2d 446 (4th Cir., 1960) when it observed at 450:

> "The general rule as to the power of the Court to determine its own jurisdiction is stated in 21 C.J.S. Courts § 113 (1940) as follows: 'Every Court has judicial power to hear and determine, or inquire into the question of its own jurisdiction, both as to parties and as to subject matter, and to decide all questions, whether of law or fact, the decision of which is necessary to determine the question of jurisdiction. ***'"

In the instant case, however, the Fifth Circuit has taken the opposite position, thus in effect stripping the district courts of their power to inquire into the fundamental question of their own jurisdiction at a preliminary hearing. The Fifth Circuit is now holding that even if a defendant presents uncontroverted evidence proving that the jurisdictional allegations in the complaint are untrue, the court must nevertheless try the case on the merits.

The case which most closely resembles the instant cause of action is *Spears* v. *Spears,* 162 F.2d 345 (6th Cir., 1947) cert. denied, 332 U.S. 768 (1947). In *Spears,* the appellants filed a complaint which upon its face adequately alleged subject matter jurisdiction. The complaint was carefully drawn to avoid mentioning its true import, which was to invalidate a will which had been accepted for probate by a state court. Probate, like divorce, is an area exclusively within the jurisdiction of the state courts. The appellants in *Spears* made the identical contention which Respondent made to the Fifth Circuit below. The court noted at 347:

> "Appellants contend that the trial court erred in considering the affidavits attached to the Motion to Dismiss, urging that the allegations of the complaint must be taken as true for the purpose of such motion."

Citing *McNutt* v. *General Motors Acceptance Corporation,* the Sixth Circuit flatly rejected this contention. The court went on to explain at 348:

> "But appellants failed to deny and in fact admitted in open court the facts as to the state court's proceedings shown in the affidavits attached to the motions, including the crucial fact that the will of August 27, 1945, a will executed subsequently to that relied on by complainant had been probated. The District Court did not err in considering the affidavits.

> Appellant's complaint is drawn to conceal the fact that they asked this court to set aside the probate of the will of August 27, 1947. The complaint constitutes a colorable attempt to meet Federal jurisdictional requirements in order to oust the state courts of jurisdiction. . . . The jurisdiction to determine the validity of the will lies exclusively in the Michigan courts . . . What appellants ask for is a secondary probate; but this is merely a continuation of a probate proceeding and the Federal Court clearly has no jurisdiction."

Similarly, in the instant case, Respondent's complaint is drawn to allege a federal securities claim. The reality, as revealed in the affidavits and exhibits considered by the trial court, is that the Respondent is seeking to improve his divorce property settlement without reopening the entire settlement, which a Texas Court would have to do. Since divorce is within the exclusive jurisdiction of the state courts, Respondent's remedy lies in the Texas courts, the only courts with jurisdiction to hear it.

The Tenth Circuit also reached the conclusion that the court could go behind the allegations in the complaint to determine if jurisdiction actually exists. In *Praire Band of Pottawatomie Tribe of Indians* v. *Puckkee,* 321 F.2d 767 (10th Cir., 1963), the complaint was drawn to seek recovery under a Federal Statute, but the court found that there was no subject matter jurisdiction. It declared at 770:

> "A genuine and substantial Federal Question must be stated, and the Court will look beyond the naked allegations of the complaint, to determine whether the asserted claim is controlled or conditioned by Federal law."

It is worth noting that the *Shahmoon Industries, Prack,* and *Spears* cases are cases brought into court under diversity jurisdiction, while the *Bonatz* and *Pottawatomie In-*

dians cases were brought into court under Federal question jurisdiction. In both types of cases, the Federal Courts look behind the plaintiff's jurisdictional allegations to determine the true jurisdictional facts.

The above cases can be reconciled with the opinions cited by the Fifth Circuit in its opinion, at 281-282: *Bell* v. *Hood,* 327 U.S. 678, 682-83 (1946); *Dann* v. *Studebaker-Packard Corp.,* 288 F.2d 201, 206 (6th Cir., 1961); *Herpich* v. *Wallace,* 430 F.2d 792, 802 (5th Cir., 1970); and *Mindes* v. *Seaman,* 453 F.2d 197 (5th Cir., 1971). The Fifth Circuit failed to differentiate between the two separate and distinct types of Rule 12(b)(1) motions. The distinction between the two types of Rule 12(b)(1) motions is explained in 5 Wright & Miller, Federal Practice and Procedure: Civil, § 1350 at Page 549:

> "A motion under Rule 12(b)(1) may be used to attack two different types of defects. The first is the pleader's failure to comply with Rule 8(a)(1), which means that te allegations in the complaint are insufficient to show that the Federal Court has jurisdiction over the subject matter of the case. If the complaint does not properly invoke the Court's jurisdiction, then the complaint is defective and unless the deficiency is cured, the motion must be granted regardless of the actual existence of subject matter jurisdiction. *The other defect that may be challenged under Rule 12(b)(1) is the Court's actual lack of jurisdiction over the subject matter, a defect that may exist despite the formal sufficiency of the allegations in the complaint.*" (emphasis supplied)

The same conclusion was reached by the Sixth Circuit in *Spears* v. *Spears, supra,* at 347-348:

> "When a motion to dismiss is used as the equivalent of a demurrer to test the legal sufficiency of the pleadings, no question of fact is presented, and under such circumstances the motion admits the well-pleaded facts of the complaint. . . . But where the motion, as here, traverses the allegations as to jurisdiction and recites

> facts de hors the record, the motion does not constitute an admission of the facts alleged in the complaint. . . . The facts set out in the affidavit attached to the motion to dismiss herein, if true, show that no jurisdiction exists in the Federal court."

In the instant case, the Motion to Dismiss for Lack of Subject Matter Jurisdiction which the petitioners filed is clearly of the second type. Petitioners concede, *arguendo,* that the Respondent's complaint formally alleges a violation of Section 10(b) of the Securities Exchange Act. However, the Petitioners have asserted that these allegations are in fact false and that when the truth was brought before the court in the form of affidavits and exhibits it could be seen that no federal jurisdiction in fact existed.

None of the cases which the Fifth Circuit cited in its opinion are Rule 12(b)(1) motions of the second type. In *Bell* v. *Hood, supra,* the plaintiffs complained of unlawful searches and seizures in violation of the Fourth and Fifth Amendments. The defendants filed a motion to dismiss for failure to state a cause of action and for summary judgment. The district judge, instead, dismissed the suit for want of federal jurisdiction because the action did not arise under the constitution or laws of the United States. The Supreme Court reversed this decision and held, at 681, that since the complaint alleged violations of the Fourth and Fifth Amendments, it was drawn to claim a right to recover under the constitution. *Bell* v. *Hood* simply is not relevant to the problem in the instant case because the defendants did not challenge the truth of the jurisdictional allegations in the plaintiff's complaint and ask the court to determine the actual jurisdictional facts.

In *Dann* v. *Studebaker-Packard Corp., supra,* the defendants filed a motion to dismiss for lack of subject matter

jurisdiction and because the complaint failed to state a claim, and because the complaint failed to comply with the requirements for a class action. It is difficult to ascertain the basis for the decision because, as the court noted at 205:

> "The District Judge granted the motion to dismiss without so much as a hint as to his reason for doing so. As a result, we are now considerably handicapped by not knowing which of the above grounds he relied upon."

However, it is clear that the defendants had not attacked the truth of the complaint's jurisdictional allegations and asked the district court to determine the actual jurisdictional facts. The Court of Appeals made his apparent when it observed at 206:

> "In the case before us, the issues for our consideration all come up on a motion attacking the form of the pleadings. Therefore, the only material necessary for the proper disposition of such a motion is the pleadings themselves, which, of course, are a part of this record."

The Petitioners in this cause of action have not attacked the form of Respondent's pleadings, but instead challenged the truth of the jurisdictional allegations.

In *Herpich* v. *Wallace, supra,* there is no suggestion in the opinion that the defendants challenged the veracity of the jurisdictional allegations of the plaintiff's amended complaint. In the absence of such a challenge, the general rule that the well-pleaded allegations in a plaintiff's complaint must be accepted as true no doubt applies. However, this offers little guidance in deciding a case where the plaintiff's allegations are controverted by a defendant. Moreover, the page cited from *Herpich* by the Fifth Circuit in the instant case makes clear that the principal concern of the

court there was a motion to dismiss for failure to state a claim. The court declared at 802:

> "Moreover, '[i]n appraising the sufficiency of the complaint we follow, of course, the accepted rule that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of its claim which would entitle him to relief.'"

In *Mindes* v. *Seaman, supra,* before an answer or any responsive pleading was filed, the court dismissed for want of jurisdiction. Accordingly, at page 198, the Fifth Circuit ruled that the allegations of the plaintiff's complaint must be taken as admitted *in the procedural posture of that case.* Once again, however, the defendant made no effort to show that the jurisdictional allegations were untrue. In fact, as far as can be determined from the opinion, the defendant never moved to dismiss for lack of jurisdiction.

Thus, none of the cases cited by the Fifth Circuit in its opinion are in any way dispositive of the issue presented in the instant cause of action, since in none of the above cases, did the defendant attack the truth of plaintiff's jurisdictional allegations. The instant case does not fall in this category, because Petitioners have shown by evidence that the Respondent's jurisdictional allegations are untrue, and it is on that basis that they contend no subject matter jurisdiction exists.

This second type of Rule 12(b)(1) motion, which asks the trial court to go behind the allegations to determine the actual facts, has been sanctioned as proper by the Supreme Court and by the Third, Fourth, Sixth and Tenth Circuits. The Fifth Circuit should not be allowed to reach a contrary result, especially when such result has been reached because of a failure to differentiate between the nature of motions filed under Rule 12(b) (1).

The position which the Fifth Circuit has taken renders Rule 12(b)(1) virtually meaningless. If a plaintiff can maintain jurisdiction by allegations alone even though the defendant is able to prove that such allegations are entirely false, then the requirements for federal jurisdiction have become mere formalities which can be sattisfied by ritual genuflections and empty verbiage. No plaintiff with a competent attorney would ever find his case dismissed for lack of jurisdiction and the overcrowded federal courts would become still more crowded. Such a result is neither desirable from a policy viewpoint nor would it lead to more equitable results.

In the instant cause of action, the District Court considered lengthy affidavits and numerous exhibits. It listened to extensive oral argument from counsel, and when it asked counsel for both sides if an evidentiary hearing was needed, both counsel answerd in the negative. After studying all the evidence before it, the trial court, consistent with the great weight of authority, concluded that the plaintiff's allegations were false and that jurisdiction did not exist. The Fifth Circuit's reversal will render every case alleging jurisdiction to be sacrosanct until the case is tried on its merits, thus effectively eliminating Rule 12(b)(1).

Since jurisdiction must be decided by the court and can not be determined by a jury, the result of the Fifth Circuit's opinion is that at the time of trial the District Court will once again determine the same issue largely on the evidence which it has already had before it. It may well reach the same decision at that point, but not until many months have passed and thousands of dollars have gone to waste.

The Fifth Circuit, by its decision, has taken away from its district courts a power which they always had possessed. At a time when the federal courts are staggering under an increasingly heavy burden of cases, a policy which permits

causes of action to remain in the federal courts even when the allegations which placed them there in the first place have been found to be untrue by a District Court after a full hearing and with a full supporting record, is a grievous waste of scarce judicial resources. Moreover, it places a heavy burden both as to time and expense on the Petitioners at a time when it is not even clear that they are properly before the court in the first place. As the court remarked in *Hilton* v. *W. T. Grant Co.*, 212 F.Supp. 126 (W.D.Pa., 1962) at 130:

> "It is also true that, just as taxation is one of the inescapable burdens of life in a civilized society . . . so is the necessity of defending unmeritorious litigation. . . . No method has yet been devised for escaping these burdens; but the burdens incident to the status of a defendant ought not to be augmented until it is certain that the party involved really is properly a defendant."

CONCLUSION

Petitioners submit that their Writ of Certiorari should be granted for three reasons. First, the Fifth Circuit dismissed the trial court's finding that the transaction which is the basis of this lawsuit was not a "sale" within the meaning of the Securities Act merely by observing that the transaction complained of fell within the literal definition of a "sale". However, the Supreme Court's decisions in *United Housing Foundation, Inc.* v. *Forman* and *Kern County Land Co.* v. *Occidental Petroleum Corp.* make it clear that this is not a proper standard to apply to determine whether a transaction falls within the Securities Acts, and that instead the Fifth Circuit should have looked at the economic realities of the transactions involved.

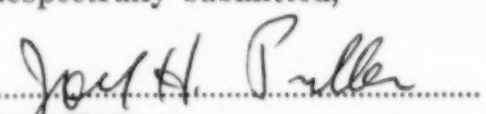
Second, the Fifth Circuit agreed with the district court's finding that this law suit arose out of a divorce property

settlement. Nevertheless, without discussion, it concluded that the Federal Securities laws apply to divorce property settlements. By so holding, the Fifth Circuit thrust the federal courts into the field of divorce and domestic relations. The Supreme Court and other federal courts have reiterated for more than a century that this field is an area in which the state courts have exclusive jurisdiction and the federal courts have none.

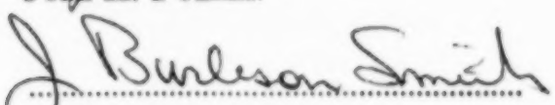
Third, the Fifth Circuit decided this case operating under the rule that when a motion to dismiss for lack of subject matter jurisdiction is heard, the jurisdictional allegations in a plaintiff's complaint must be taken as true. However, this is not the rule and has never been the rule in those instances where the defendant has challenged the truth of the jurisdictional allegations in the plaintiff's complaint. The Fifth Circuit's holding flatly contradicts and conflicts with decisions of the Supreme Court and the Third, Fourth, Sixth and Tenth Circuit Courts of Appeals.

For each of these reasons, the Supreme Court should grant Petitioners' Writ of Certiorari, and place this case on its calendar for oral argument.

Respectfully submitted,



JOEL H. PULLEN



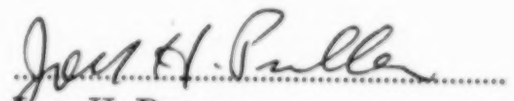
J. BURLESON SMITH

CHARLES M. JEFFERSON

Attorneys for Petitioners

CERTIFICATE OF SERVICE

I, JOEL H. PULLEN, do hereby certify that true and correct copies of the foregoing Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit have been mailed to Lang, Cross, Ladon, Boldrick & Green, Attorneys at Law, 1565 Frost Bank Tower, San Antonio, Texas 78205, and Mitchell & Stewart, Attorneys at Law, 1540 Milam Building, San Antonio, Texas, 78205, counsel for Respondent herein, on this the 10th day of November, 1975.



JOEL H. PULLEN

APPENDIX

APPENDIX A

pp. 1a - 19a

BERNARD D. SPECTOR,
Plaintiff-Appellant,

v.

L Q MOTOR INNS, INC., *et al.*,
Defendants-Appellees.

No. 74-2549.

UNITED STATES COURT OF APPEALS,
FIFTH CIRCUIT.

Aug. 8, 1975.

Husband who had received stock, which had been registered in his wife's name, in connection with property settlement, who had sold the stock back to the corporation after receiving assurances from the incorporators, one of whom was his wife, that the corporation's stock was not to be offered to the public, brought action against the incorporators and a successor corporation after the original corporation's assets had been transferred to the successor corporation and that corporation's stock had been offered to the public. The District Court for the Western District of Texas, John H. Wood, Jr., J., dismissed for lack of jurisdiction under the Securities Exchange Act, and husband appealed. The District Court, Gibson, Circuit Judge of the Eighth Circuit, sitting by designation, held that husband's allegations that incorporators had misrepresented to him their intention as to a public offering and that the public offering had brought a higher price for the stock in the successor corporation than husband had been paid for his stock was sufficient to allege the existence of a "sale" within meaning of the Securities Exchange Act and to state a claim within the jurisdiction of the Act.

Reversed and remanded.

1. Courts (Key) 486.5(6)

On appeal from dismissal for lack of jurisdiction, well pleaded allegations of the complaint must be taken as true.

2. Courts (Key) 406.1(11)

In reviewing dismissal of complaint for lack of jurisdiction under the Securities Exchange Act, court is limited to observing whether the complaint is drawn to seek recovery under the federal statute and, if so, determining whether, as a matter of law, the federal claim clearly appears to be immaterial and made solely for the purpose of obtaining jurisdiction or is wholly insubstantial and frivolous. Securities Exchange Act of 1934, § 27, 15 U.S.C.A. § 78aa.

3. Courts (Key) 299.3(1)

Jurisdiction is not defeated by the possibility that the averments might fail to state a cause of action or because the plaintiff might be unable to prove his case; such failures call for dismissal on the merits, not on jurisdictional grounds.

4. Courts (Key) 489(1)

Although divorce and its attendant property settlement are controlled by state law, husband's securities fraud claim against former wife and other incorporators of corporation, stock of whose predecessor husband received as part of property settlement, fell within subject matter jurisdiction of federal courts. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

5. Courts (Key) 289(6)

Where husband brought action against former wife and other incorporators of corporation, stock of whose predecessor husband had received as part of property settlement, fact that the action might be barred by collateral estoppel impact of facts adjudicated in the divorce settlement did not demonstrate lack of jurisdiction in federal court under the Securities Exchange Act. Securities Exchange Act of 1934, §§ 10(b), 27, 15 U.S.C.A. §§ 78j(b), 78aa.

6. Federal Civil Procedure (Key) 1951

In action brought by husband against former wife and other incorporators of corporation based on alleged securities laws violations in connection with husband's sale of stock back to the corporation's predecessor, question of husband's entitlement to recover and question of federal court's jurisdiction over the transaction as a "sale" under the Securities Exchange Act were factually meshed and district court should have considered the merits of the controversy in a plenary hearing in order to insure a proper determination of jurisdiction; decision on the merits should have been reserved until a hearing on the merits. Securities Exchange Act of 1934, §§ 10(b), 27, 15 U.S.C.A. §§ 78j(b), 78aa; Fed.Rules Civ.Proc. rule 12(d), 28 U.S.C.A.

7. Securities Regulation (Key) 60

Husband's allegations that he received, in property settlement, shares of stock in corporation owned by his wife and others, that the stock had been community property registered in his wife's name, that he sold the stock back to the corporation, that the incorporators misled him by stating that they did not have any plans at that time to sell the stock to the public, and that the incorporators thereafter formed a new corporation with the assets of the old and

sold the stock to the public at a price in excess of that received by the husband stated a claim for violation of securities laws. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

8. Courts (Key) 359.1(12)

Precise nature of husband's interest in 40 shares of stock registered in his wife's name was a matter governed by Texas property law.

9. Securities Regulation (Key) 43, 64

Husband's allegations that shares of stock registered in his wife's name were community property and that, before property settlement in which he received some of the shares, which he sold back to the corporation, he individually owned an interest in some of them, that he sold the shares back to the corporation upon assurances that the corporate stock was not to be the subject of public offering, and that the incorporators then transferred the assets of the corporation to a new corporation and offered stock in that corporation to the public at a price in excess of that paid to the husband alleged a "sale" of securities by the husband within meaning of Securities Exchange Act of 1934, §§ 3(a)(14), 10(b), 15 U.S.C.A. §§78c(a)(14), 78j(b).

See publication Words and Phrases for other judicial constructions and definitions.

10. Husband and Wife (Key) 262.1(1)

In community property state such as Texas, beneficial interests of husband and wife in community property are presumptively equal, whether nominal title is in the wife, in the husband, or in both jointly; if, during marriage, property is placed in the wife's name, only legal title vests

in her and equitable title to husband's one-half of the property remains in him.

11. Husband and Wife (Key) 272

Under Texas law, community property remains such unless formally partitioned in one spouse's name in accordance with Texas statutory law or unless transferred by gift from one spouse to the other.

12. Courts (Key) 299.3(2)

Husband who alleged that he had sold certain shares of stock to corporation upon assurances that corporation's stock would not be offerd to the public and that the corporation's assets were thereafter transferred to another corporation whose stock was offered to the public and that he obtained a much lower price for his stock than was paid by the public adequately alleged injury in fact to give husband standing, within case or controversy requirement, to bring securities fraud action against the incorporators and the successor corporation. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); U.S.C.A. Const. art. 3, § 1 et seq.

13. Securities Regulation (Key) 64

Term "purchase or sale," as used in statute prohibiting use of deceptive and manipulative devices in connection with purchase or sale of securities, and as used in SEC rule relating to the same subject, is not limited to technical common-law sales. Securities Exchange Act of 1934, §§ 3(a)(14), 10(b), 15 U.S.C.A. §§ 78c(a)(14), 78j(b).

See publication Words and Phrases for other judicial constructions and definitions.

14. Securities Regulation (Key) 2

Terms of Securities Exchange Act are to be broadly construed to effectuate the Act's remedial purpose. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

15. Securities Regulation (Key) 139

Husband who alleged that he had obtained shares of stock in corporation in connection with property settlement, that he had sold the shares back to the corporation after obtaining assurances that the corporation's stock was not to be offered to the public, that the incorporators, who included his former wife, thereafter transferred the assets of the corporation to a new corporation and offered successor corporation's stock to the public, and that he received less for his shares than the successor corporation received from the public sufficiently alleged fraud in connection with the sale of a security. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

16. Securities Regulation (Key) 120

Husband who alleged that he had received stock, which had been registered in his wife's name, in connection with property settlement, that he had sold the stock back to the corporation, and that he had been misled by representations made when he sold the stock and thus received less than he should have was arguably within the zone of interest to be protected by the Securities Exchange Act and thus had standing to bring action against the incorporators. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); U.S.C.A.Const. art. 3, § 1 et seq.

17. Courts (Key) 489(1)

Availability of relief under Texas law did not deprive plaintiff of federal forum for his securities fraud action. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

Ernest J. Altgelt, III, James D. Stewart, San Antonio, Tex., for plaintiff-appellant.

Joel Pullen, J. Burleson Smith, San Antonio, Tex., for defendants-appellees.

Appeal from the United States District Court for the Western District of Texas.

Before GIBSON,* THORNBERRY and AINSWORTH, Circuit Judges.

GIBSON, Circuit Judge.

This fraud action involves a sale of securities used to fund a divorce property settlement between Bernard D. Spector, the plaintiff, and his wife. Violations of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j (1970), SEC Rule 10b—5, 17 C.F.R. § 240.-10b—5 (1974), and pendent state claims[1] are alleged against L J Motor Inns, Inc., its controlling shareholder-directors, Samuel E. Barshop, Philip M. Barshop, and Norman S. Davis, and the plaintiff's former wife, Doris Barshop Spector. Jurisdiction is invoked under § 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa (1970).[2] Diversity of citizen-

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* Of the Eight Circuit, sitting by designation.

[1] As pendent claims Spector alleges state securities fraud, breach of fiduciary duty, common law fraud and unjust enrichment.

[2] The statute reads in part:

> The district courts of the United States * * * shall have exclusive jurisdiction of violations of this chapter [2B] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.

ship is lacking, so federal jurisdiction rests solely upon the alleged Securities Act violation.

The plaintiff seeks $1,144,406 in damages plus attorney's fees. The defendants, without filing an answer, moved to dismiss for lack of jurisdiction. The District Court after a nonevidentiary hearing granted the motion on the basis that the alleged "sale" of securities was not "the type of transaction intended to be protected and covered" by § 10(b) and Rule 10b—5. We reverse and remand for a plenary hearing on the merits.

[1, 2] Since this is an appeal from dismissal for lack of jurisdiction, the well-pleaded allegations of the complaint must be taken as true. *Mindes* v. *Seaman,* 453 F.2d 197 (5th Cir. 1971); *Herpich* v. *Wallace,* 430 F.2d 792, 802 (5th Cir. 1970). Our review is limited to observing whether the complaint is drawn to seek recovery under a federal statute, and if so, determining whether as a matter of law the federal claim "clearly appears to be immaterial and made solely for the purpose of obtaining jurisdiction or • • • is wholly insubstantial and frivolous." *Bell* v. *Hood,* 327 U.S. 678, 682-83, 66 S.Ct. 773, 776, 90 L.Ed. 939 (1946). If not, dismissal for lack of jurisdiction was error. *Dann* v. *Studebaker-Packard Corp.,* 288 F.2d 201, 206 (6th Cir. 1961).

[3, 4] Jurisdiction is not defeated by the possibility that the averments might fail to state a cause of action or because the plaintiff is unable to prove his case. Such failures call for dismissal on the merits, not on jurisdictional grounds. *Bell* v. *Hood, supra* at 682, 66 S.Ct. 773. To be sure, this case presents a novel factual setting for a federal claim of securities fraud, as it arises out of a property settlement in a divorce action. Although the divorce and its attendant property settlement are controlled by state law, plaintiff's 10b—5 claim falls within the subject matter

jurisdiction of the federal courts. Whether plaintiff is entitled to relief depends upon a number of factual questions. The key issue appears to us to be whether plaintiff was the legal and equitable owner of the securities in question with full rights of disposal, unfettered by controlling restrictions on alienation.

The transaction urged as a basis for federal jurisdiction was a transfer of 18 shares of common stock by Spector as part of a divorce property settlement concluded with his wife in the District Court of Bexar County, Texas, March 16, 1972. Immediately after entry of the divorce decree the parties executed and exchanged some 20 documents prepared in advance by counsel for both sides which were the product of two years of negotiation that began in 1969 when Mrs. Spector filed for divorce.

The Spectors' community estate, itemized in the final settlement agreement, included 40 shares of common stock in Barshop Motel Enterprises, Inc. (BME), a privately held predecessor to defendant L Q Motor Inns, Inc., a publicly, held Delaware corporation operating a chain of 31 inns in southwestern states. BME was one of various business interests owned by Mrs. Spector's family, the Barshops. The certificate for the 40 shares of BME stock was registered in Mrs. Spector's name and constituted one-third of the outstanding capital stock of BME. From the start of the negotiations Spector claimed community ownership in the stock. In partial settlement of Spector's community property claims, he was issued a certificate for 18 of the 40 BME shares.[3] A stock purchase agreement was executed by BME contemporaneously, obliging Spector to immediately endorse the certificate back to BME in exchange

[3] The new certificate was dated March 14, 1972, two days before the divorce decree. It represented 15% ownership of the corporation.

for $70,000 cash and a secured promissory note in the amount of $300,000. Spector received other community assets and liabilities in the settlement as well, free of Mrs. Spector's claims.

Soon after BME purchased Spector's 18 shares, the defendants Barshop acquired the stock from BME for the same price, and in June, 1972, they incorporated as L Q Motor Inns, registered with the S.E.C., exchanged BME's assets for L Q stock and successfully sold L Q securities to the public. They acquired an equivalent 151,406 shares of L Q in exchange for the 18 BME shares purchased from Spector and in turn sold them publicly for $1,862,294.[4]

Plaintiff Spector alleged in his complaint, without mentioning the divorce, that during the negotiations for sale of his BME shares he inquired of BME's representatives (the defendants) "as to the current status of [BME's] efforts to effectuate a public sale of its securities." The defendants' response was that discussions with brokerage houses concerning public financing were under way but that there was "not presently in effect any contractual agreement for any such public financing."

BME's formal purchase agreement dated March 16, 1972, contained an express warranty to the same effect—disclaiming the existence of any present public financing contract.[5] The defendants inserted the warranty into the draft

[4] Thus, in effect, the defendants bought the shares from plaintiff for the equivalent of $2.44 per share and sold them publicly at $12.30 per share. They were able as well to raise $615,000 for the corporation in the public offering.

[5] The BME stock purchase agreement drafted by BMS's counsel states in relevant part:

RECITALS

* * * * * *

[T]here have been discussions with various brokerage houses in the past concerning such public sale of securities and/or public financing and/or mergers with third parties and * * * such discussions are continuing and are expected to continue in the future, but BME has warranted to Spector that there is not presently in effect any contractual agreement for any such public financing * * * (Emphasis added.)

agreement at the request of the plaintiff. Before they signed the warranty on March 16, 1972, however, plaintiff alleges, the defendants had already conducted "discussions, made plans, and [taken] steps to effectuate an exchange offer" in which a new corporation would be formed to acquire BME's assets and to sell securities to the public.[6]

As the basis for his claim of federal jurisdiction Spector argues that the transaction was a "sale" of securities and that the defendants in the March 16, 1972, agreement willfully concealed material facts—that the ultimately successful public offering had already been proposed and specific details discussed with the chosen underwriter. Disclosure of the proposed public sale, Spector argues, was necessary in the circumstances to prevent BME's statements from being misleading to him. And, had the defendants disclosed

[6] The extent to which these plans were then finalized into a "public financing contract" are in dispute. In his brief on appeal to this court the plaintiff alleges that in June, 1971, three of the defendants met officers of E. F. Hutton & Co. concerning a public offering of securities of the chain of motels controlled by BME. After the conference a vice-president of E. F. Hutton's New York corporate underwriting department reportedly stated in a letter to BME:

> Based on what we know to date, it appears eminently reasonable to expect a highly successful offering for BME early in 1972 * *.

During the fall and winter of 1971, BME's counsel continued working on the proposed public offering with E. F. Hutton. On March 8, 1972, the week before BME purchased Spector's 18 shares, defendant Davis and a member of his law firm attended a conference in San Antonio between the Barshops and three officers of E F. Hutton. It was then agreed, plaintiff alleges, that a prospectus would be prepared and filed with the S.E.C. for a public offering of roughly 300,000 shares at approximately $15.00 per share.

their plans to him he would have "refused to sell his common stock, or any part thereof, at the price at which it was actually sold."

The only question now presented is whether the trial court erred in dismissing the suit for lack of jurisdiction without hearing the merits. Allegations of a violation of § 10(b) and Rule 10b–5 were made, but no proof was offered beyond the documents relating to the property settlement negotiations, divorce decree and L Q Motor Inns' public financing.[7] At the end of the hearing the court summarily dismissed the suit, finding that the plaintiff's cause of action grew out of an indivisible property settlement in the divorce action and concluding that the instant transaction was not of a type intended to be covered by the Act.[8] Plaintiff, of course, was still free to seek relief in the Texas courts.

[5] In support of dismissal, the defendants argue that the court lacks subject matter jurisdiction because no "sale" of securities took place. Spector, they argue, merely agreed to settle his community property claims against his wife in exchange for $400,000. The 18 shares of BME stock was used as a medium or device to supply $370,000 of the $400,000 settlement. The Barshops agreed (through BME) to issue Spector 18 shares of stock only for the purpose of purchasing it back from him immediately for $70,000 cash and a $300,000 note. At no time, they argue, did any "separate, independent negotiations [take place] which were

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[7] The documents included correspondence between Spector's counsel and counsel for Mrs. Spector (and BME) detailing the proposed property settlement, the settlement agreement itself, the judgment of divorce, the BME stock purchase agreement, the exchange offer and bill of sale transferring BME's assets to L Q Motor Inns, and L Q prospectus, memoranda to the court, and affidavits of defendants' counsel discussing the transaction.

[8] The court's May 7, 1974, memorandum opinion is unreported.

unrelated to the divorce suit based solely on a true purchase and sale of the BME shares." The stock purchase was simply "the means used to get this money to Spector."[9]

[6] The District Court, we believe, should have considered more extensively the merits of the controversy in a plenary hearing in order to insure a proper determination of jurisdiction. The jurisdictional and substantive issues are factually meshed. Therefore, decision on the jurisdictional issues is dependent on decision of the merits and should have been reserved until a hearing on the merits. *Land* v. *Dollar,* 330 U.S. 731, 67 S.Ct. 1009, 91 L.Ed. 1209 (1947); *McBeath* v. *Inter-American Citizens for Decency Committee,* 374 F.2d (5th Cir.), *cert. denied,* 389 U.S. 896, 88 S.Ct. 216, 19 L.Ed.2d 214 (1967). If the plaintiff prevails on his theory on the merits then he would also prevail on the jurisdictional issue. It is impossible to decide one without the other. *See also Gulf Oil Corp.* v. *Copp Paving Co.,* 419 U.S. 186, 213–14, 95 S.Ct. 392, 42 L.Ed.2d 378 n. 10 (1974)

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[9] In short, the defendants argue that the plaintiff is trying to cast his claim in 10b-5 terms because in that posture he has a "risk free shot" at improving his divorce settlement by more than one million dollars. That may be true, but to characterize the instant case as no more than a relitigation of the divorce action is to miss the point of Spector's complaint.

Hardy v. *Bankers Life & Cas. Co.,* 232 F.2d 205 (7th Cir.), *cert. denied,* 351 U.S. 984, 76 S.Ct. 1051, 100 L.Ed. 1498 (1956), upon which defendants rely, is inapposite here. It was a civil diversity action for conspiracy in which summary judgment was granted and affirmed upon res judicata grounds because the claim was foreclosed by a prior settlement in a state divorce proceeding involving substantially the same parties. The same claim of fraud was raised in the divorce action and rejected by the state court against the plaintiff. The instant case, however, is a 10b-5 claim dismissed on jurisdictional grounds involving issues not revealed by the record as having been litigated in the state divorce court. We intimate no view, however, of the possible collateral estoppal impact of facts adjudicated in the divorce settlement.

(Douglas, J., dissenting).[10] Such a procedure is authorized by Rule 12(d), Fed.R. Civ.P.

[7] Dismissal for failure to state a claim would also be inappropriate on the present record. It does not appear "to a certainty" that Spector would *not* be entitled to recover under any state of facts which could be proved in support of his claim. *Cook & Nichol, Inc.* v. *Plimsoll Club,* 451 F.2d 505, 506–07 (5th Cir. 1971). Moreover, because a decision on the merits in this case involves close factual questions of intent, reliance, and motive, along with legal questions on the significance of property rights recognized or created by the divorce settlement, summary judgment without a plenary hearing would be inappropriate. We do not suggest, however, that a directed verdict for the defendants might not be appropriate after all the evidence is in nor do we intimate any view on the merits of either party's position.

[8-11] That a sale of securities was alleged and can be proved by the plaintiff cannot be realistically disputed here. The precise nature of Spector's interest in the 40 BME shares registered in his wife's name is a matter governed by Texas property law and is not now before use. Suffice it to say, however, that the plaintiff has alleged facts which, with the documentary evidence before the District Court on the motion to dismiss, support a finding that the 40 shares were community property and that before the divorce settlement Spector individually owned an interest in at least some of them, notwithstanding that the shares were registered

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[10] *Cf. The Fair* v. *Kohler Die Co.,* 228 U.S. 22, 25, 33 S.Ct. 410, 412, 57 L.Ed. 716 (1913), in which Mr. Justice Holmes stated:

> [W]hen the plaintiff bases his cause of action .upon an act of Congress, jurisdiction cannot be defeated by a plea denying the merits of the claim. • • • [I]f the plaintiff really makes a substantial claim under an act of Congress, there is jurisdiction whether the claim ultimately be held good or bad.

in his wife's name.[11] Thus, at this early stage in the proceedings, plaintiff is entitled to an inference that at all relevant times, even before the property settlement, he owned an alienable interest in the BME stock. *See Hilley* v. *Hilley,* 342 S.W.2d 565, 568 (Tex.1961).

That Spector requested the defendants to insert the warranty into the BME stock purchase agreement to disclaim the existence of a public financing contract lends credibility to his claim of ownership. If Spector viewed his interest in the 18 shares as merely that of a pay-out conduit, as defendants argue, BME's future plans for financing would be of no concern to him. However, at this stage in the case we have no idea what the facts were. Thus, to dismiss the exchange of stock as merely part of an "indivisible" divorce settlement not cognizable under 10b-5 was premature. In the divorce settlement, of course, Spector's

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[11] In community property states such as Texas, the beneficial interests of husband and wife in community property are presumptively equal, whether nominal title is in the wife, husband or both jointly. Thus, if during marriage property is placed in the wife's name, only legal title vests in her and equitable title to the husband's one-half of the property remains in him. *Carter* v. *Barnes,* 16 S.W.2d 136, 139 (Tex.Civ.App.1929), *rev'd on other grounds,* 25 S.W.2d 606 (Tex.Comm.App.1930). Community property remains such unless formally partitioned in one spouse's name in accord with Texas statutory law, or unless transferred by gift from one spouse to the other. *Hilley* v. *Hilley,* 342 S.W.2d 565, 567-68, 571 (Tex.1961).

The instant record contains no findings of fact and scant evidence concerning the method by which Mrs. Spector acquired the certificate for 40 shares of BME stock — whether by gift, descent, or purchase with separate or community funds. Nor are there facts revealing any intent of the husband and wife that she would acquire the shares as her separate property, and no evidence of formal partition has been offered by the defendants to indicate such intent. On the contrary, there appears to be a judicial admission by the defendants and a similar decree by the Texas divorce court that Mr. and Mrs. Spector owned 40 shares as community property before the divorce and that Spector owned 18 shares free and clear of claims by his wife thereafter.

community property equity in BME was liquidated to 18 shares and a stock certificate was issued to him March 14, 1972. The contract of sale to BME was executed two days late, March 16, 1972, immediately after the property settlement was approved and the divorce decree entered in state court. To label this transaction a "sale" requires no strained construction of that term.[12]

We believe the issue presented here can better be framed as a question of standing to be decided within the framework of the case or controversy requirement of Article III of the Constitution. *Herpich* v. *Wallace,* 430 F.2d 792, 805 (5th Cir. 1970). In determining whether a 10b-5 plaintiff has standing to invoke the federal remedy:

> "[T]he first question is whether the plaintiff alleges that the challenged [conduct] has caused him injury in fact, economic or otherwise." The second question is whether "the interest sought to be protected by the complainant is arguably within the zone of interests to be protected" by section 10(b) and Rule 10b-5 thereunder.

Herpich v. *Wallace, supra* at 805 (citations omitted).

[12-16] The first question can be resolved easily. There is no doubt that Spector adequately alleged injury in fact. He claims he was deprived by the defendants of a reasonable opportunity to make an informed, intelligent decision regarding his sale of the securities and suffered a loss in

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[12] Section 3(a)(14) of the Act, 15 U.S.C. § 78c(a)(14) (1970), states:

Definitions and Application.

(a) *Definitions.*
When used in this chapter, unless the context otherwise requires —

• • • • • •

(14) The terms "sale" and "sell" each include any contract to sell or otherwise dispose of.

the sense of deprivation of a foreseeably more profitable sale had he known of the public financing plans.

The second question — whether the interest Spector seeks to protect is arguably within the zone of interests to be protected by the Act — reduces to whether the plaintiff has alleged with reasonable clarity that he sold securities that he had a right to sell, and that the sale was the subject of the fraudulent scheme or that the inducement of the sale was a purpose of the scheme. *Herpich* v. *Wallace, supra* at 808-09. The "purchase or sale" referred to in the statute and rule are not limited to technical common-law sales. *Dasho* v. *Susquehanna Corp.,* 380 F.2d 262 (7th Cir.), *cert. denied sub nom. Bard* v. *Dasho,* 389 U.S. 977, 88 S.Ct. 480, 19 L.Ed.2d 470 (1967); *see Hooper* v. *Mountain States Securities Corp.,* 282 F.2d 195 (5th Cir. 1960), *cert. denied,* 365 U.S. 814, 81 S.Ct. 695, 5 L.Ed.2d 693 (1961). The terms of the Act are to be broadly construed to effectuate its remedial purpose. *Tcherepnin* v. *Knight,* 389 U.S. 332, 88 S.Ct. 548, 19 L.Ed.2d 564 (1967). We conclude that the plaintiff has adequately alleged fraud in connection with a sale of securities.

[17] The availability of relief under Texas law does not deprive Spector of his federal forum. *Superintendent of Insurance* v. *Bankers Life & Casualty Co.,* 404 U.S. 6, 12, 92 S.Ct. 165, 30 L.Ed.2d 128 (1971). However, he must still prove his federal claim. We hold only that plaintiff must be given a chance to do so and that the court has jurisdiction to determine its jurisdiction by proceeding to a hearing on the merits.

The judgment of dismissal is reversed and the case remanded for further proceedings consistent with this opinion.

United States Court of Appeals

FOR THE FIFTH CIRCUIT

OCTOBER TERM, 1974

No. 74-2549

D. C. DOCKET NO. CA 73-285

BERNARD D. SPECTOR,
Plaintiff-Appellant,

v.

L Q MOTOR INNS, INC., ET AL.,
Defendants-Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF TEXAS

Before GIBSON,* THORNBERRY and AINSWORTH, Circuit Judges.

J U D G M E N T

This cause came on to be heard on the transcript of the record from the United States District Court for the Western District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed; and that this cause be, and the same is hereby remanded to the said District Court for further proceedings consistent with the opinion of this Court;

It is further ordered that defendants-appellees pay to plaintiff-appellant, the costs on appeal to be taxed by the Clerk of this Court.

August 8, 1975

Issued as Mandate:

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* Of the Eighth Circuit, sitting by designation.

United States Court of Appeals

FIFTH CIRCUIT

Office of the Clerk

October 3, 1975

TO ALL COUNSEL OF RECORD

No. 74-2549

Bernard D. Spector v. LQ Motor Inns, Inc., et al.

Dear Counsel:

This is to advise that an order has this day been entered denying the petition(x) for rehearing, and no member of the panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 12) the petition(x) for rehearing en banc has also been denied.

See Rule 41, Federal Rules of Appellate Procedure for issuance and stay of the mandate.

Very truly yours,

EDWARD W. WADSWORTH,
Clerk

By CLARE F. SACHI
Deputy Clerk

cc: Mr. Ernest J. Altgelt, III
Mr. James D. Stewart
Mr. Joel Pullen
Mr. J. Burleson Smith

APPENDIX B

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IN THE
UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

BERNARD D. SPECTOR

Plaintiff,

CA No. SA-73-CA-285

SAMUEL E. BARSHOP, PHILIP M. BARSHOP, DORIS BARSHOP SPECTOR, NORMAN S. DAVIS and L Q MOTOR INNS, INC.

Defendants.

MEMORANDUM AND ORDER DISMISSING CAUSE FOR LACK OF JURISDICTION

On the 24th day of April, 1974, came on to be heard Defendants' Motion to Dismiss this cause for lack of jurisdiction. All parties announced ready on the motion upon the record then before the Court.

Plaintiff's sole basis for Federal jurisdiction is alleged violations of Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C.78j) and Rule 10(b)-5 promulgated thereunder by the Securities and Exchange Commission. In addition, Plaintiff alleges violations of the Texas securities laws, common law fraud and breach of fiduciary duties. These, of course, are based upon pendent jurisdiction and must be dismissed unless there is a viable Federal claim supporting jurisdiction in this Court.

After considering the pleadings, the record including the affidavits and other materials filed by the parties, and the briefs and argument of counsel, the Court found, and now finds, that:

1. Plaintiff's alleged causes of action grow out of an indivisible property settlement in a divorce action in which final judgment was entered in a Texas State Court of competent jurisdiction over divorce property settlements;

2. There were no separate independent negotiations concerning the value of any particular shares of stock involved in the divorce settlement, but, rather, the parties first agreed on a dollar amount which the Plaintiff here (the Defendant in the Divorce Action) would receive as his part of the partition of the property involved in the divorce settlement and then they agreed upon a method of realizing that dollar amount so determined. The method agreed upon by them prior to the entry of the divorce decree awarded to the Plaintiff here certain shares of stock which the Defendant Doris Barshop Spector was obligated to buy (or to provide a buyer) and which the Plaintiff here was obligated to transfer for an agreed consideration immediately after the entry of the divorce decree. This agreement made before the entry of the divorce decree was executed and consummated, as agreed, immediately after the entry of the divorce decree, which also approved the property settlement, all as a part of the overall agreement between the parties.

3. The Plaintiff here is attempting to re-open an indivisible property settlement without tendering what he received in the settlement or without having sought relief in the Texas State Court which entered the divorce decree and approved the property settlement; and

4. The Plaintiff can obtain all of the relief to which he is entitled in the Texas State Courts, and his counsel so conceded in open Court on oral argument.

Accordingly, the Court concludes (1) that this is not the type of transaction intended to be protected and covered by Section 10(b) and (2) that this Court has no jurisdiction over the alleged Federal cause of action. Accordingly, Defendants' Motion to Dismiss is granted as to all causes of action alleged in the Plaintiff's Complaint.

Entered this 7th day of May, 1974.

/s/ JOHN H. WOOD, JR.
John H. Wood, Jr.
United States District Judge

San Antonio, Texas
May 7, 1974

APPENDIX C

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Securities Exchange Act of 1934 — 15 § 78c

Definitions and application — Definitions

(a) When used in this chapter, unless the context otherwise requires —

(14) The terms "sale" and "sell" each include any contract to sell or otherwise dispose of.

Securities Exchange Act of 1934 — 15 § 78j

Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

S.E.C. Rule 17 C.F.R. 240.106-5. Employment of Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

Federal Rule of Civil Procedure 12(b)

Rule 12. Defenses and Objections — When and How Presented — By Pleading or Motion — Motion for Judgment on Pleadings

(b) How Presented. Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, cross-claim, or third-party claim, shall be asserted in the responsive pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion: (1) lack of jurisdiction over the subject matter, (2) lack of jurisdiction over the person, (3) improper venue, (4) insufficiency of process, (5) insufficiency of service of process, (6) failure to state a claim upon which relief can be granted, (7) failure to join an indispensable party. A motion making any of these defenses shall be made before pleading if a further pleading is permitted. No defense or objection is waived by being joined with one or more other defenses or objections in a responsive pleading or motion. If a pleading sets forth a claim for relief to which the adverse party is not required to serve a responsive pleading, he may assert at the trial any defense in law or fact to that claim for relief. If, on a motion asserting the defense numbered (6) to dismiss for failure of the pleading to state a claim upon which relief can be

granted, matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.